STATEMENT OF DR. KEITH COLLINS
CHIEF ECONOMIST
U.S. DEPARTMENT OF AGRICULTURE
BEFORE THE
HOUSE COMMITTEE ON AGRICULTURE

June 26, 2003

Mr. Chairman and Members of the Committee, thank you for the invitation to this hearing to provide information on Section 10816 of the 2002 Farm Bill, the mandatory country of origin labeling provision for meats, fish, perishable commodities and peanuts. My comments focus on the economic analysis the Department of Agriculture (USDA) must conduct in support of the proposed rule that is expected to be promulgated this year.

Analysis Requirements

Various laws, orders, and regulations prescribe the analyses that have to be conducted as part of a rule making process. USDA will provide an in-depth economic analysis to accompany the proposed and final rules for mandatory country of origin labeling. USDA and the Office of Management and Budget have determined that the rule for mandatory country of origin labeling is economically significant under Section 3 (f) (1) of Executive Order 12866 (Order). This means that the rule is likely to result in an annual effect on the economy of $100 million or more or have other material effects, such as on a sector of the economy or on competition or other factors. Under this classification, the Order requires that USDA must provide an assessment of the benefits and costs of the planned action and of potentially effective and reasonably feasible alternatives to the planned action.

A cost-benefit analysis generally estimates the consequences of the changes in behavior of those affected by the regulation. The consequences are presented in monetary terms to the extent possible. Data, models, assumptions and uncertainties should be identified. Although a range of options should be examined for any rule, that range may be limited by the legislation.

The Agricultural Marketing Service (AMS) is responsible for ensuring that adequate economic analyses support the mandatory country of origin rule, and it is drawing on a team of experts from around USDA to conduct the cost-benefit analysis. The team is using the best available information on the costs and benefits of labeling as well as information provided to AMS through the three public comment periods it has held to date and from the education and listening sessions held around the country since March.

While the cost-benefit analysis to accompany the proposed rule is now underway, USDA staff and others have previously conducted analyses on the economic effects of mandatory country of origin labeling. That work is the basis for USDA concerns that have been raised about the expected net benefits of the rule. I want to illustrate these concerns by discussing several factors affecting the benefits and costs identified by these analyses.

General Observations on Benefits

Starting with the benefit side of mandatory country of origin labeling, some suggest that expected benefits stem from consumers preferring to have the label information so that they can choose to buy products by country of origin. Some claim that if consumers prefer to buy products of domestic origin over those that are not labeled or are labeled as originating in a foreign country, then there would be increased quantities demanded of retail domestic products and the likelihood of increased prices of retail domestic products. These higher prices and quantities at retail would generate higher prices and production through the system back to the farm. Consumers would benefit by having the information they need to make the choices they want, and those supplying the products would benefit by selling more at a higher price. USDA's cost-benefit analysis will assess whether these benefits occur.

For consumers to believe the label information, the program must be enforced to ensure against false claims. Some have proposed self-certification or raised questions about the level of recordkeeping that may be required. A general point is that if recordkeeping is inadequate to ensure the integrity of the program, consumers will not believe the label information and no benefits are likely. Trust requires verification and verification comes at some cost.

There is compelling evidence that the strength of consumer preference for domestic products is weak. This evidence is the lack of active voluntary programs that provide products labeled as domestic origin. Several years ago, USDA's Food Safety and Inspection Service in conjunction with AMS began offering the opportunity for a U.S.-origin meat labeling program for processors and others. FSIS would permit product to be labeled as domestic, and AMS would provide the process verification program to verify the label claim. No firms or organizations have participated in the program. Assuming that there are at least some U.S. processors who could implement a process verification program at reasonable cost, this lack of participation suggests that retailers and their suppliers believe consumer demand for domestic product compared with imported product is not strong.

If consumers do distinguish goods depending on their country of origin, strong incentives exist for industries to act without government intervention, that is, on a voluntary basis. A similar example to the preference for buying products by country of origin is the demonstrated preference by some consumers for organic foods. Like the attribute AU.S. origin,@ the attribute Aorganic@ generally cannot be discerned by taste or smell. Under various voluntary certification schemes, consumers can express their preferences and are willing to pay a premium, which is sufficient to cover the additional costs incurred by organic producers and sellers. This market-driven outcome is preferable to mandating that all food be organic or that all food be labeled according to method of production. While the market has given us the evidence that consumers are willing to pay for organic, it has not done so for U.S. origin.

Although some have argued that there is a benefit to a consumer's right to know that should be considered even if there is no demand effect of labeling, that benefit is not quantifiable.

We do not know of studies that have measured through actual market transactions the effect of country of origin labeling on consumer demand and concluded that the effect is large or that it will persist. One approach to gauging the preference of consumers for country of origin labeling comes from comments USDA received on the voluntary guidelines. A food retailer with 5 stores in the mid-Atlantic region noted that it received 38,000 customer communications last year, and none were about country of origin labeling. Similarly, another food retailer with 100 stores in the Midwest and South indicated that it received 22,000 customer calls last year. Only nine calls pertained to country of origin, and only one of those dealt with a covered commodity.

To measure the strength of consumer preference in the absence of market data, some economists have tried so-called Awillingness-to-pay@ methods to estimate the existence and strength of consumer demand for domestic over imported product or product without an origin label. Willingness to pay studies show that as many as 75 percent of U.S. consumers are willing to pay more for beef identified as U.S. born and raised, compared with beef that is not. Reasons suggested are that consumers perceive U.S. beef as safer, they believe it is higher quality or they desire to support U.S. agricultural producers. There are no data to suggest that imported beef sold in the U.S. is less safe than U.S. beef, nor can one conclude that imported meat is inferior in quality. Regardless of the reasons for consumers expressing a desire for this information, what is one to make of studies that say U.S. consumers are willing to pay more for U.S. beef? Such work must be treated with great care because the results are highly uncertain.

First, the survey respondents' reactions are a function of the questions asked. A different questionnaire will yield a different outcome. For example, one recent study asks if consumers will pay more for U.S. beef but the question does not include Acompared to what.@ The respondent is left to decide whether they want U.S. beef or beef from who knows where. If consumers already believe they are buying U.S. beef and suddenly the package is labeled U.S. beef, it seems unlikely a price premium for domestic beef would emerge in the market.

Second, the respondent faces no real budget constraint. They are asked if they are willing to pay more, and may be asked to bid, but they are not spending funds from their household's budget. Third, if consumers say they are willing to pay more initially, will they be willing to pay more the next day, the next month or the next year? Other industries with country of origin labeling, such as apparel, suggest origin preference will not persist if imported product provides similar quality at similar or better prices. An interesting example was recently reported in a trade publication concerning a Danish company that had stopped selling pork certified to have been produced with non-biotech feeds. The company had offered the pork as a test product, selling at a 10-15 percent premium. However, consumers were unwilling to pay the premium, despite surveys that indicated consumers wanted bio-tech free food.

The willingness-to-pay studies are an important contribution to our understanding of consumer preference and they support the notion that some consumers are indeed willing to pay more for U.S. beef compared with imported beef. But, even if some consumers are in fact willing to pay more for U.S. beef, can a price premium be captured in the marketplace? The chances are that it cannot, because the supply of U.S. beef is likely to far exceed the quantity demanded by those who actually would pay more. If studies show 75 percent of consumers hypothetically express a willingness to pay more for U.S. beef, then in the budget-constrained real world, the share of the population that actually would pay more is likely to be less, perhaps far less, than 75 percent, while the U.S. beef share of the total U.S. market exceeds 80 percent. Any attempt to price U.S. beef at a premium would result in excess supplies of U.S. beef at the premium price, which would result in the premium being competed down to a market clearing price.

While more analysis of benefits of mandatory country of origin labeling must surely be done, the work to date suggests very modest quantifiable benefits at best. The above discussion assesses consumer and producer benefits apart from the costs of implementation. If costs imposed on suppliers and retailers are large and exceed the benefits to consumers, then while prices of the covered commodities may rise, the quantity of meat demanded by consumers may decline. This result occurs when the implementation costs passed forward to consumers exceed the price premium consumers would pay for the origin information. In this case, farmers and ranchers could see lower farm-level prices, a lower market share, and higher operating costs for some. Let me now turn to a brief discussion of the costs of mandatory country of origin labeling.

General Observations on Costs

The expected costs of country-of-origin labeling fall into several categories. A 2000 USDA study, as requested by the 1999 Agriculture Appropriations Act, noted the major costs associated with country-of-origin labeling of meats were related to segregating and preserving the identity of imported and domestic product, labeling, and enforcement. The ultimate costs of country-of-origin labeling will depend on the number of the new activities required to comply with the regulations, and on the extent to which any new activities differ from current production and marketing practices. Firms will incur resource costs to the extent they have to reconfigure processing systems; implement new control/verification systems, including recordkeeping systems; produce signage or labels, and train staff. The government will incur costs to the extent that it conducts audits and other compliance activities.

Last fall, as part of the requirements of the Paperwork Reduction Act of 1995 associated with publishing the interim voluntary guidelines, AMS estimated the annual recordkeeping costs of creating and maintaining a voluntary country-of-origin system to be nearly $2 billion. These costs did not include any other resource, labeling, or enforcement costs. The estimates were preliminary and based on limited data and several critical assumptions. The estimate assumed *all* producers, handlers, and retailers would participate in the country-of-origin program, although in actuality all do not engage in producing or buying and selling the covered commodities. AMS also assumed that *no* records or record-keeping systems incorporating country of origin information and already otherwise required by Federal regulation were in place, and completely new systems would have to be createdCa critical assumption. AMS noted costs would decline over time and would be about $1.4 billion in subsequent years. Relaxing any of these assumptions would reduce the recordkeeping costs.

Several studies have reviewed the AMS estimates and the views range widely, from the belief the costs are seriously underestimated to the opposite view that costs are significantly overestimated. Therefore, reviewing these recordkeeping cost estimates will be a crucial component of the USDA cost analysis. Because the legislation is not specific as to what records will be required, except to note that the Secretary cannot mandate an identification system, the analysis of various options for verification systems may be necessary to assess least-cost alternatives. Much of the information on country of origin likely exists, but there is little reason for it to flow from one step in the supply chain to the next. Thus, there will be costs in transmitting that information through the system.

In addition to recordkeeping costs, another key area for the analysis will be the resource costs, which have been variously described as costs of segregation or preserving the identity of domestic versus imported product. These costs will reflect both the share of imported product used in domestic processing and retailing, as well as the specific manufacturing processes for each sector. USDA will likely have to analyze these costs on a sector-by-sector basis. In that regard, several studies have focused specifically on meats and live animals because of the highly integrated nature of North American beef and pork sectors.

Several studies have estimated costs for the cattle/beef and hog/pork sectors at between $1 - 3 billion annually, after examining costs for the entire supply chain, including identifying and tracking animals, reconfiguring processing plants, and retail tracking and labeling. Other studies have estimates above and below this range. The studies note that over 80 percent of U.S. beef consumption and almost 90 percent of pork consumption comes from domestic sources. Because food service establishments, restaurants, and ingredients in processed products are exempt from country-of-origin labeling, the implications for end use of imported versus domestic product in the beef and pork sectors will be a crucial area to examine.

Less work has been done on other covered commodities, but a few studies have looked at the cost implications for frozen food, fish and seafood, and fresh produce. We are not aware of any studies on peanuts. Again, depending on the assumptions used in the studies, the costs of implementation could be significant. We will examine these studies carefully as we conduct our cost-benefit analysis.

Another key question is who will bear the costs, which relates directly to the issue of assessing benefits from country-of-origin labeling. The direct burden of labeling falls on retail establishments, but where and how these and additional costs are distributed along the supply chain from farmers to consumers depends on the ability of the various participants to absorb or pass the additional costs on to buyers or back to suppliers. Although producers of covered commoditiesCfarmers and ranchersCare not directly affected by the requirements, many are concerned that costs of segregation and identity maintenance will be pushed back onto them, in addition to their recordkeeping costs.

On the other hand, retailers may attempt to push their costs on to consumers. To the extent consumers do not care where their food comes from, increased costs would reduce their welfare. Consumers might prefer domestic products, but not enough to cover labeling costs. For producers, even if consumers do favor domestic over imported products to the point that it expands demand, costs imposed on producers directly and passed back to them may outweigh the benefits from increased demand.

Other Impacts

USDA will also examine the implications of mandatory country of origin labeling for trade, both on the import and export side. Depending on the commodity, trade accounts for a significant share of production and consumption. As noted above, over 80 percent of U.S. beef consumption and almost 90 percent of pork consumption comes from domestic sources, but exports of beef and pork have become increasingly important. Fish and shellfish imports now account for over two-thirds of U.S. consumption of these products. About 9 percent of vegetable consumption comes from imports and almost 20 percent of fruits and nuts consumption (includes juices) is accounted for by imports. Exports of fruits, nuts, and juices account for over 13 percent of domestic output, and the share for vegetables is 8 percent, up from 5 percent a decade ago. For peanuts, exports have ranged from 15-20 percent of production, while imports have grown as a result of trade reform and are now almost 10 percent of domestic food use. Trade implications will mainly derive from potentially price effects on covered commodities. Again, the implications may be most significant for the beef and pork sectors because of the flows of animals and meats in an integrated North American market.

That completes my statement and I would be pleased to respond to questions.